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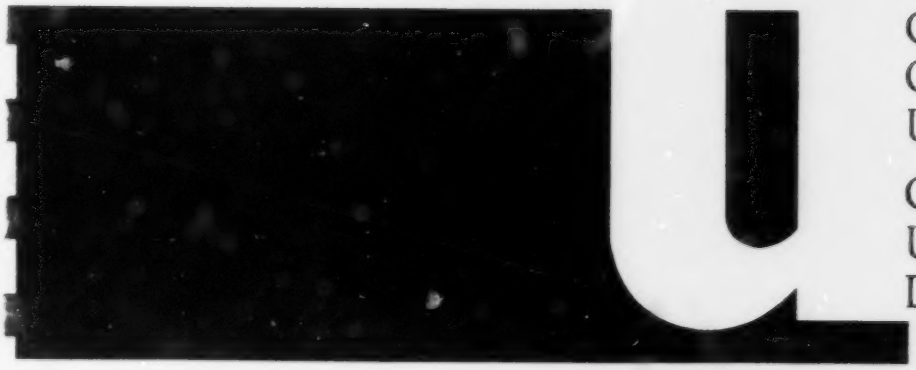
UNIVERSITY FINANCIAL PROSPECTS FOR 1990-91

A Brief to the Standing Committee on Finance and Economic Affairs



COUNCIL OF ONTARIO UNIVERSITIES

CONSEIL DES UNIVERSITÉS DE L'ONTARIO

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UNIVERSITY FINANCIAL PROSPECTS FOR 1990-91

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Council of Ontario Universities
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January 1990

University Financial Prospects for 1990-91

A Brief to the Standing Committee on Finance and Economic Affairs

In preparing its funding advice for next year, the Ontario Council on University Affairs noted that a shortfall of $129.2 million existed in 1989-90 between its basic funding objectives and the actual revenues of this province's university institutions. Against the backdrop of this shortfall, OCUA assessed university basic financial needs for 1990-91 at 14.1%, including a grant increase for accessibility announced by the Government in June 1989. With no specific provision for a prior year's shortfall, the Council of Ontario Universities recommended a grant increase of 11.7%. The Treasurer of Ontario announced in December 1989 an increase in operating grants and tuition fee rates of 8%.

There are a number of "first charges" against this 8% increase, as a consequence of government initiatives and incentives (see Figure 1 below). Significant among these is the 3.1% identified by the Government as required to meet the costs of recent enrolment increases.

Other government initiatives and contractual obligations also have to be paid for. These include the net additional costs of the Employer Health Tax (1.3% of total compensation), the costs associated with implementation of pay equity (1.0%), statutory increases in CPP and UIC employer contributions (0.1% and 0.3% respectively), and the net costs of career progress (1.2%). With compensation at 80% of total costs, these will consume a further 3.1% of total revenue.

Figure 1
Summary of University Financial Position for 1990-91

Grant Increase Provided			8.0%
Deduct:	Accessibility Funding		3.1%
Increase in Base Funding			4.9%
Deduct:	Statutory and Contractual Compensation Costs		
	Employer Health Tax	1.3%	
	Pay Equity	1.0%	
	Unemployment Insurance	0.3%	
	Canada Pension	0.1%	
	Contractual Career Progress	1.2%	
		3.9%	3.1%
Available for real cost increases			1.8%

When these sums are subtracted, the universities are left with only 1.8% "real" increase in resources. This is at a time when inflation, with the introduction of the GST anticipated part way through the university fiscal year, is expected to approach 6.0%. This funding gap is the largest experienced in many years and is the reason why Ontario universities face their bleakest financial year in recent memory.

In Spring 1987, universities agreed, despite constrained institutional capacity, to increase enrolment in order to maintain the Government's policy of broad accessibility *provided that all enrolment growth incurred was fully funded*. At the time such enrolment growth was being considered, many expressed the concern that despite its promises, the Government would effectively meet its obligations by taking the requisite funds "off the top" of its regular funding increase. Universities must conclude that their worst expectations have materialized. The gap between their minimum financial requirements and the level of funding announced (3.7%) exceeds the provision for accessibility (3.1%). Universities have effectively been afforded no increase at all for enrolment growth.

How can this critical situation be addressed in the face of the decisions already made regarding the level of basic transfer payments and increases in tuition fees? Two areas are identified where prompt government action would be and would be seen to be in the best interests of the province and its universities. These are the employer health tax and the provision of special funds for priority areas.

The first, essentially mechanical, operation would be for government to commit itself to an ongoing arrangement whereby universities were fully compensated for the costs of the employer health tax that exceed previous OHIP payments. These significant costs and the unique position of universities confronting them were recognized by the Treasurer last June when he announced special funding for universities and colleges for employer health tax costs which would be incurred in fiscal 1989-90. The universities' circumstances in this regard have not changed since last June. The net costs of implementing the employer health tax are greater for them than for any other sector of the economy. This, combined with the Government's virtually total control over operating revenue, affords universities little opportunity to meet these costs. Appendix A includes a brief on the employer health tax which was prepared for the Standing Committee on Finance and Economic Affairs last November.

The Treasurer committed himself in the Legislative Assembly to take into account the impact of the employer health tax on transfer agencies when funding priorities for 1990-91 were being established. In the case of universities, it is not apparent that this has happened.

The second initiative government might take to relieve financial pressure on universities in the coming fiscal year would be the provision of grants for specific priority areas of great need as identified by the government, its advisory agency, the Ontario Council on University Affairs, and the universities. This approach has been successfully employed by the present government in the past.

Critical areas to which such funding might be directed are faculty renewal, equipment, and library acquisitions. Deferred maintenance might also be addressed in this way (see Appendix B). OCUA, in its advisory memorandum to the Ministry of Colleges and Universities, has called for supplementary funding in the form of an Excellence Fund. In accordance with OCUA's advice, both students (through a special levy) and government might share the costs of creating some or all of these targeted funds. As well, the Government should consider some strategic enrolment funding adjustments particularly in the areas of teacher training and graduate studies. Increased graduate enrolment might also be encouraged through more numerous and more generous graduate fellowships.

In the context of 1990-91 funding, COU must also note its profound disappointment that the matter of tuition fee policy remains unresolved. In May, COU endorsed the Queen's proposal, *Blueprint for Action*, which called for a partnership between universities, government and students to enhance overall levels of support for universities and to focus such enhanced funding on qualitative improvements in the university enterprise. COU reiterates its view that no single stakeholder should bear an undue burden of these changes. Increased tuition fees cannot substitute for basic government support. In this respect, the introduction of excellence funds might offer, therefore, a unique vehicle for an evolving partnership. For the longer term, COU continues to believe that a major review of tuition fee policy is required.

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COUNCIL OF ONTARIO UNIVERSITIES
CONSEIL DES UNIVERSITÉS DE L'ONTARIO

The Financial Impact of the Employer Health Tax on the Universities of Ontario

Summary

- The role government proposes for the universities in the life of the province must be matched by the financial resources made available to them.
- The Council of Ontario Universities does not oppose the concept of an Employer Health Tax in place of contributions to the Ontario Health Insurance Plan, but the perhaps unforeseen consequences for the universities must be recognized.
- The **net** cost of the Employer Health Tax (tax minus previously paid OHIP) to Ontario universities will be $24.3 million. This represents 1.3% of gross payroll expenditures.
- Two factors account for these high costs:
  - While professors are scarcely overpaid, the large number of professionals at universities means that average salaries are high;
  - Financial constraints have meant that university benefits schemes are less generous than many. Universities pay a small percentage of OHIP costs.
- Anticipated cost increases for universities will require an overall increase in revenues of 11.7% in 1990-91 just for university operations to remain at last year's level. This includes the additional costs of the Employer Health Tax.
- Universities have no capacity of their own to raise revenues. Operating grants and tuition fees are controlled by government.
- The Treasurer has promised relief for the first three months of the new tax. A permanent mechanism must be sought.
- The simple inclusion of a general provision for the Employer Health Tax in the base grants of transfer payment recipients will seriously disadvantage universities, whose net costs are high relative to other public sector employers.
- Universities could be protected from the negative effects of the proposed levy either by exemption, by explicit provision for the net costs of the tax in transfer payments for 1990-91, or by a rebate programme similar to the programme of grants in lieu of municipal taxation.

The Financial Impact of the Employer Health Tax on the Universities of Ontario

Ontario's universities play an important role in the life of the province. Over the past number of years, their resources have been seriously constrained by limitations in the level of government grants on which they largely depend for revenues. It is in this context and in anticipation of significantly increased costs for the coming year, 1990-91, that the universities of Ontario raise specific concerns about the Employer Health Tax.

On 12 December, 1988, the Treasurer of Ontario announced an increase in university operating grants for 1989-90 of 7.5%. As the Minister of Colleges and Universities elaborated the following day, the increased funding included "a four per cent increase in base operating support" and an additional amount of 3.5% largely in recognition of enrolment growth. A 4% increase in base support now stands in sharp contrast to a projection of inflation for 1989 of 5.8%. Universities were expected, it seems, to absorb fully one third of increased inflation-related costs out of existing budgets. It is in this context and in anticipation of significantly increased costs for 1990-91 that the universities of Ontario raise specific concerns about the Employer Health Tax.

Financial Impact on Ontario Universities

Table 1 sets out an estimate of the financial impact on universities of the Employer Health Tax. Gross costs on an annualized basis are put at $37.5 million. Estimated recoveries from cessation of payment of employer-paid OHIP premiums are put at $13.2 million. The net cost to the universities of this province will be, therefore, about $24.3 million in current dollars. Net costs vary significantly by institution (see Appendix).

How can a tax measure that was intended to be relatively revenue neutral have such a negative impact on one particular employer group? Universities differ from typical employers, particularly private sector employers, in at least two ways. Although individual salaries are not high relatively speaking, because they employ large numbers of professionals, universities have high average salaries when measured across all employees. The salary pyramid typical of most employers is not applicable in a university context. In 1987-88, it is estimated that the average wage per full time university employee was slightly over $40,000; the average industrial wage for Ontario for the same period was $24,000. A payroll tax clearly has greater impact relatively on employers with higher average salaries.

In addition, universities have traditionally covered a smaller portion of OHIP costs (about two-thirds) than is typical with other employer groups. This reflects universities' lower provision for benefits generally; it is a fact of life for a university community that has sustained over a decade of constrained

funding. Figure 1 compares benefit costs relative to salaries for Ontario universities and for the Ontario government. The Government supplements salaries with an additional 16.8% in benefits compensation; the comparable figure for universities is 11.6%. In addition, therefore, to having a relatively higher salary base against which an employer health levy might be assessed, universities will recover significantly less as a result of the elimination of employer OHIP contributions than is typical for other sectors. The result is the significant net additional costs already adverted to.

We believe that these net costs are considerably higher for universities than they are for other employers. Table 2 displays data compiled for a discussion paper on tax reform published by Treasury in May 1982 when a payroll tax of 2% was being considered. With the exception of the federal government in Ontario, no employer or employer group was liable for greater net costs as a percentage of payroll than were universities. We have no reason to believe that this situation has changed substantially.

Other New Costs in 1990-91

These considerable costs will be compounded in the coming year by significant other costs attributable to specific government initiatives. Most notable among these is the 1% additional salary requirement arising from the implementation of pay equity on 1 January, 1990. In addition, recent measures introduced by the federal government with respect to unemployment insurance will add $5.4 million to universities' employer benefit contributions. More difficult to quantify are the costs arising from a range of provincial government initiatives with respect to employment equity, occupational health and safety, and environmental issues, but these costs will be substantial. In addition, the general legislative and regulatory framework within which we operate has become more complex and places significant demands on university administrative services. In and of itself, the proposed Goods and Services Tax represents a considerable challenge to universities. Universities' minimum financial requirements for 1990-91 are estimated at 11.7% (see attached Notes to the Treasurer). These include an estimated net cost of 1.3% of salaries for the Employer Health Tax.

In meeting these costs, it is important to note a further important distinction exists between universities and other public and private sector employers. While others have a significant degree of control over their capacity to raise revenues to cover increased costs, universities do not. Municipalities and school boards have taxing powers; utilities can increase rates; private companies can raise prices. University revenues are virtually totally regulated. This gives them no flexibility in responding to unanticipated cost increases. When government virtually controls total revenue, government must be addressed to adjust revenue when costs increase.

A Mechanism for Resolution

The universities of Ontario accept that important social goals are being pursued in the introduction of the employer health levy. Nonetheless, given

their particular financial circumstances and the significant impact of the proposed levy on their net benefit costs, universities have no alternative but to urge that, in some manner or other, they be protected from the proposed levy. This could be achieved in one of two ways. From the universities' perspective, the simplest solution would be to be declared exempt from the levy. Alternatively, a programme of rebates to cover the costs of the levy, while administratively more complicated, would also be acceptable. A parallel could be drawn with the current provincial programme of grants in lieu of municipal taxation.

Universities welcomed the initiative of the Treasurer to provide additional funding in 1989-90 to cover the cost of the first three months of the new tax. They also noted with interest his remarks in the Legislature to the effect that the additional costs associated with the employer health levy would be taken into account when determining levels of transfer payments for 1990-91. Universities are not at the moment encouraged that this will indeed occur in sufficient volume or with sufficient discrimination to respect their particular position. Universities would also wish to note that announced levels of increase in transfer payments subsume a host of factors which are recognized implicitly as contributing to their financial needs. It is important that any relief from the employer health tax be explicitly identified when transfer payments are announced.

Congruence Among Priorities

Government policy in its broadest terms finds expression in the allocative decisions which governments make among competing priorities. We can only assume that announced funding levels for universities will be based on a thorough assessment of revenues and needs and some sense of the importance which higher education is seen to have in contributing to the achievement of the government's overall objectives. Specific government measures which place an additional financial burden on the activities being supported clearly intrude upon government's initial assessment of what can be accomplished with available funds and undermine, we believe, the overall process of policy development. Government measures, however, which arbitrarily impact recipients of transfer payments in significantly different ways change government priorities in a similarly arbitrary manner. The Council of Ontario Universities will welcome the support of the Committee on Finance and Economic Affairs in addressing this important matter.

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Table 1

FINANCIAL IMPACT OF THE EMPLOYER HEALTH TAX
ON THE UNIVERSITIES OF ONTARIO
($000s)

	Operating	Ancillary Enterprises	Sponsored Research	Other Funds	Total
Fiscal 1989-90					
Gross Cost	10,429	579	1,139	281	12,428
OHIP Recovery	3,729	253	285	67	4,334
Net Costs	6,700	326	854	214	8,094
Annualized Costs					
Gross Cost	31,469	1,769	3,447	851	37,536
OHIP Recovery	11,399	774	872	202	13,247
Net Costs	20,070	995	2,575	649	24,289

FIGURE 1

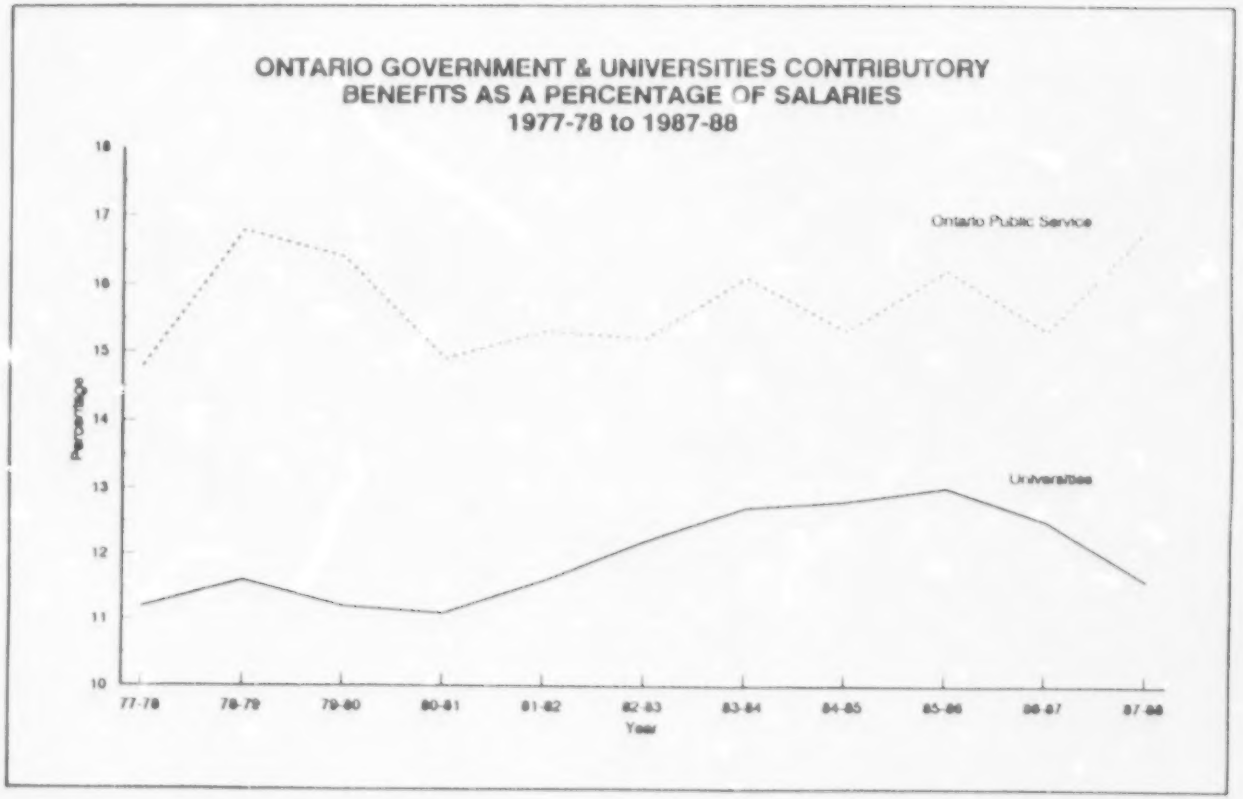

ONTARIO GOVERNMENT & UNIVERSITIES CONTRIBUTORY
BENEFITS AS A PERCENTAGE OF SALARIES
1977-78 to 1987-88
Percentage
18
17
16
15
14
13
12
11
10
Ontario Public Service
Universities
77-78
78-79
79-80
80-81
81-82
82-83
83-84
84-85
85-86
86-87
87-88
Year

Table 2
Shifts in Industry, Public Sector, and Universities' Net Cash Outflow Created by a Payroll Tax, 1981
($ millions)

Private Industry	OHIP Payment (1)	Payroll Tax (2)	Difference (2) - (1)	Effect on Corporate Income Tax	Net Cash Outflow	Net Cash Outflow as a % of Payroll
Forestry	1.6	3.7	2.1	-1.0	1.1	0.61
Mining	16.7	18.3	1.6	-0.7	0.9	0.09
Food, Beverages and Tobacco Products	36.9	39.4	2.5	-0.9	1.6	0.08
Rubber Products	14.7	13.1	-1.6	0.6	-1.0	-0.16
Leather and Textile Products, Knitting Mills and Clothing	18.7	22.0	3.3	-1.2	2.1	0.18
Wood Products	6.7	6.3	-0.4	0.2	-0.2	-0.10
Furniture and Fixtures	7.3	8.0	0.7	-0.3	0.4	0.11
Paper and Allied	22.3	26.3	4.0	-1.5	2.5	0.19
Printing, Publishing and Allied	12.7	25.5	12.8	-4.8	8.0	0.63
Primary Metal	36.7	37.5	0.8	-0.3	0.5	0.03
Metal Fabricating	32.7	31.8	-0.9	0.3	-0.6	-0.03
Machinery, except Electrical	25.2	26.2	1.0	-0.4	0.6	0.05
Transportation Equipment	53.8	55.2	1.4	-0.5	0.9	0.03
Electrical Products	31.3	40.6	9.3	-3.5	5.8	0.29
Non-Metallic Mineral Products	11.8	11.8	0	0	0	0
Petroleum, Coal and Chemical Products	16.8	25.9	9.1	-3.4	5.7	0.44
Construction	9.9	74.2	64.3	-29.6	34.7	0.94
Transportation, Communication and other Utilities	55.2	94.3	38.8	-17.8	21.0	0.45
Wholesale Trade	65.8	85.8	20.0	-9.2	10.8	0.22
Retail Trade	72.2	101.0	28.8	-13.3	15.5	0.31
Finance, Insurance and Real Estate	32.4	70.6	38.2	-17.6	20.6	0.58
Recreational and Business Services	40.4	131.7	91.3	-42.0	49.3	0.75
Personal Services	32.9	82.2	49.3	-22.7	26.6	0.65
Public Sector						
Ontario Public Service	29.7	33.0	3.3	0.0	3.3	0.20
Ontario Hydro	11.7	18.0	6.3	0.0	6.3	0.70
Elementary and Secondary School Teachers	34.3	55.0	20.7	0.0	20.7	0.75
Colleges	5.1	6.6	1.5	0.0	1.5	0.46
Municipal Sector	41.9	43.3	1.4	0.0	1.4	0.06
Federal Civil Service in Ontario	13.4	47.0	33.6	0.0	33.6	1.43
Universities	8.7	20.3	11.6	0.0	11.6	1.15

Source: Ontario Treasury-sponsored private survey and Committee of Finance Officers-Universities of Ontario

Table A

FINANCIAL IMPACT OF THE EMPLOYER HEALTH TAX
ON THE UNIVERSITIES OF ONTARIO

Annualized Costs
($000)

	Operating	Ancillary Enterprises	Sponsored Research	Other Funds	Total
Gross Costs					
Brock	615	26	-	-	641
Carleton	1,581	84	166	3	1,833
Guelph	2,262	172	96	31	2,560
Lakehead	542	15	47	-	604
Laurentian	580	15	22	3	620
McMaster	2,279	69	332	170	2,850
OCA	209	-	-	-	209
O.I.S.E.	363	27	33	-	423
Ottawa	2,262	41	292	102	2,697
Queen's	2,000	80	400	160	2,640
Ryerson	1,280	55	36	4	1,375
Toronto	6,360	420	1,109 a)		7,889
Trent	430	57	19 a)		506
Waterloo	2,337	171	294	114	2,916
Western	3,384	303	434	217	4,338
Wilfrid Laurier	565	39	12	8	624
Windsor	1,267	60	31	-	1,358
York	3,153	135	126	39	3,453
TOTAL	31,469	1,769	3,447	851	37,536
OHIP Recoveries					
Brock	369	15	-	-	384
Carleton	567	48	36	-	651
Guelph	962	72	20	6	1,060
Lakehead	296	8	26	-	330
Laurentian	286	11	7	-	304
McMaster	910	30	170	8	1,118
OCA	90	-	-	-	90
O.I.S.E.	171	12	14	-	197
Ottawa	300	5	24	9	338
Queen's	900	50	50	60	1,060
Ryerson	773	33	22	2	830
Toronto	1,800	187	209 a)		2,196
Trent	205	47	6 a)		258
Waterloo	960	90	114	48	1,212
Western	887	80	114	57	1,138
Wilfrid Laurier	324	20	-	-	344
Windsor	636	24	21	-	681
York	983	42	39	12	1,056
TOTAL	11,399	774	872	202	13,247
Net Costs					
Brock	246	10	-	-	256
Carleton	1,014	36	129	3	1,182
Guelph	1,300	100	75	25	1,500
Lakehead	246	7	21	-	274
Laurentian	294	4	15	3	316
McMaster	1,369	39	162	162	1,732
OCA	119	-	-	-	119
O.I.S.E.	192	15	19	-	226
Ottawa	1,962	35	268	93	2,358
Queen's	1,100	30	350	100	1,580
Ryerson	507	22	15	2	545
Toronto	4,560	233	900 a)		5,693
Trent	225	10	13 a)		248
Waterloo	1,377	81	180	66	1,704
Western	2,497	223	320	160	3,200
Wilfrid Laurier	241	19	12	8	280
Windsor	631	36	10	-	677
York	2,190	93	87	27	2,397
TOTAL	20,070	993	2,575	649	24,287

a) Includes both sponsored research and restricted (Toronto) or other (Trent) funds

Excellence Funding

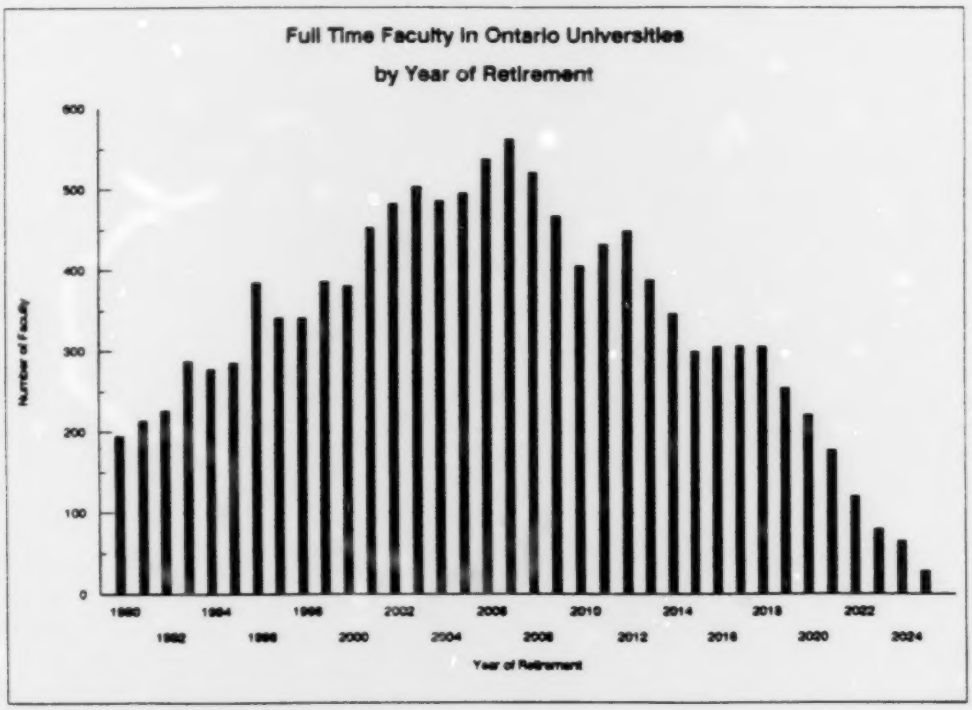
In October, 1985, the Government of Ontario announced the establishment of a $50 million University Excellence Fund to provide for faculty renewal, research leadership, and library enhancement and instructional equipment. In 1988-89, the monies provided for excellence funding were incorporated into the universities' funding base, although specific envelopes for faculty renewal and research leadership continue to be separately identified in university operating grants. Specific provision for library enhancement and instructional equipment were discontinued in 1988-89. In view of recent significant increases in enrolment, the impact of such increased enrolment on quality, and the serious but unavoidable financial circumstances in which universities find themselves in facing 1990-91, the universities of Ontario believe that a new initiative in excellence funding needs to be initiated for next year.

Faculty Renewal

Under the terms of the Government's original provision for faculty renewal, some 500 new faculty appointments, each supported for five years, were to be made between 1986-87 and 1990-91. Plans called for 300 appointments in the first year, 70 in each of the second and third years, and 60 in each of the final years of the programme.

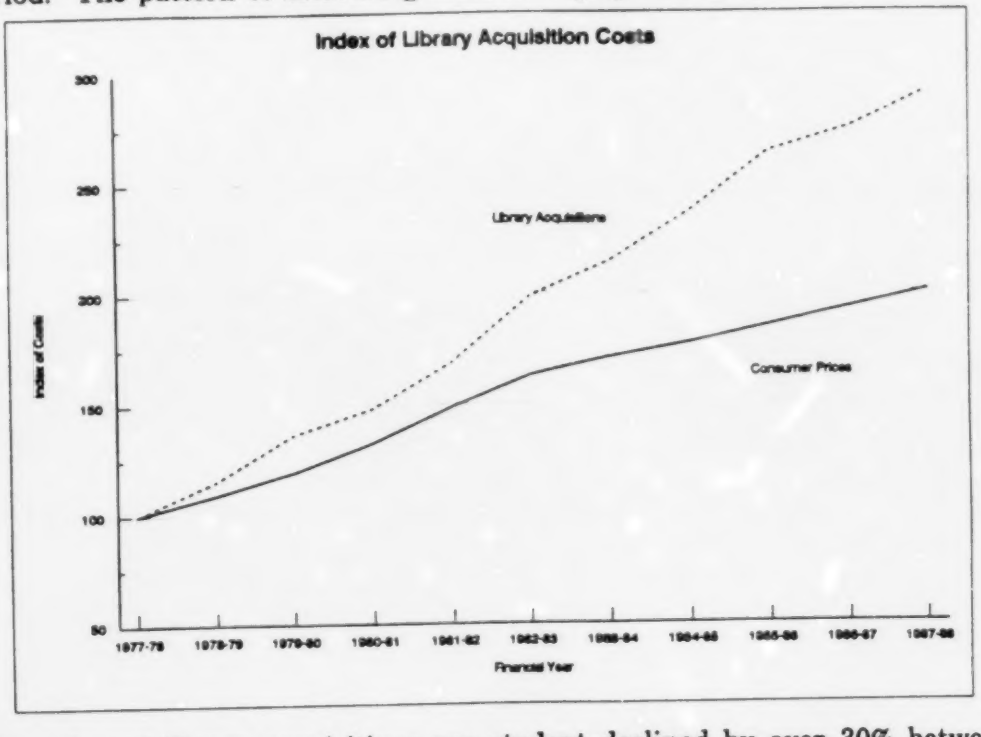
Faculty renewal funds have been used to improve the proportion of women appointed to faculty positions, to convert part-time and contractually limited positions to tenure-track status, and to provide bridge appointment funding to institutions confronted with an accelerating pace of retiring faculty who have to be replaced in coming years.

Circumstances regarding the need for faculty renewal funds have not diminished since the programme's inception in 1986-87. Although half the appointments made from these funds have gone to women, a considerable gender imbalance remains to be addressed. As well, as can be seen in the chart below, the age profile of our faculty complement remains seriously skewed, with a significant demand for faculty evident in the latter part of the 1990s and the early part of the next century. What has emerged, however, from work in other jurisdictions, is that the problem of faculty renewal has international dimensions which will seriously exacerbate the problem of faculty recruitment. A significant addition to faculty renewal funds in 1990-91 will enable the appointment of young faculty now, in anticipation of required hirings later in the decade.

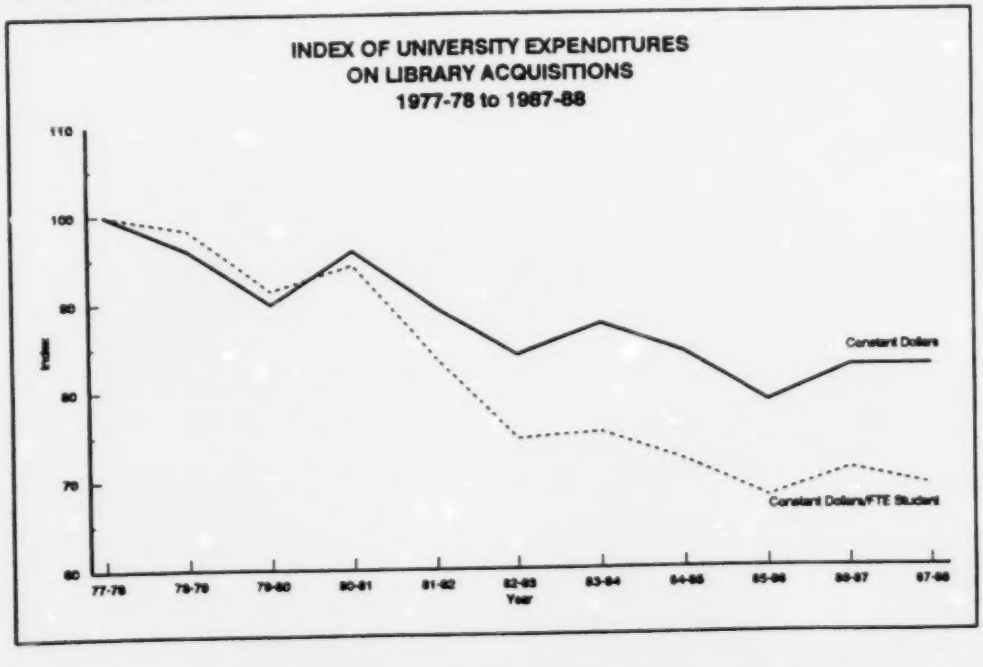


Library Acquisitions

During the period between 1977-78 and 1987-88, book and periodical prices rose by 190%. By contrast, the consumer price index rose by 100% over the same period. The pattern of increasing costs is displayed below.

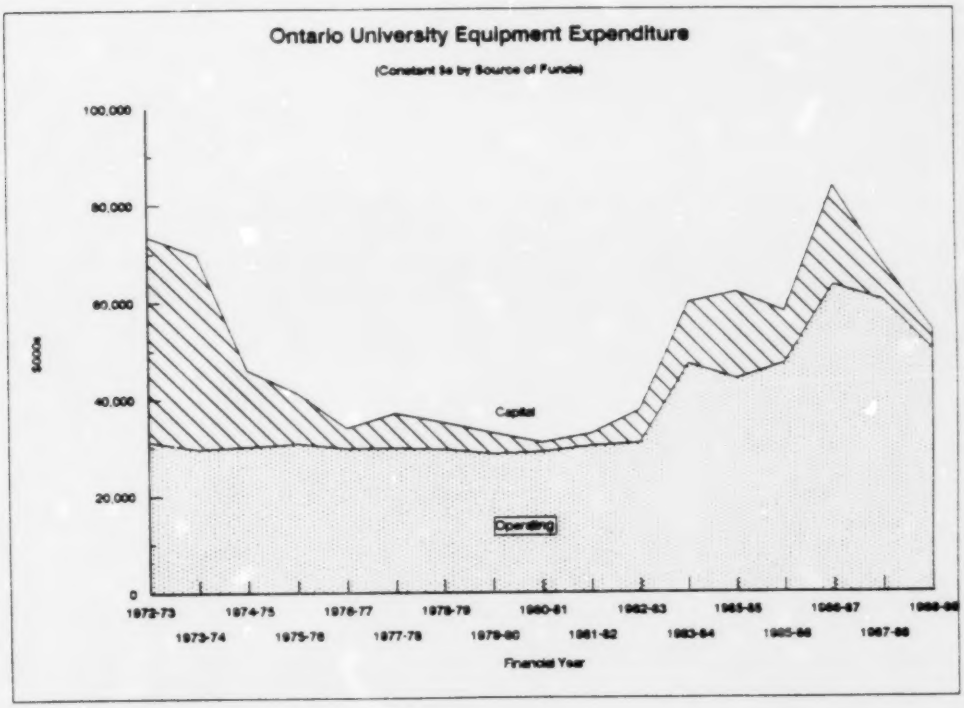


The value of library acquisitions per student declined by over 30% between 1977-78 and 1987-88. The excellence funds provided in 1986-87 temporarily arrested this decline. A new injection of funding is required to re-inforce this earlier initiative.



Equipment Renewal

Existing university equipment inventories have an estimated current value of $1.5 billion. The majority of this equipment pool has been accumulated over the past 20 years with significant input in the late 1960s and early 1970s being drawn from capital funds for new construction, as can be seen in the graph below. No specific provision was ever made in university operating grants to replace the equipment purchased from capital funds. As a consequence, equipment replacement in the late 1970s and early 1980s was substantially underfunded. The Government's excellence initiative in 1986-87 and 1987-88 together with the recent re-introduction of significant capital funding have clearly had a positive impact on equipment acquisition and replacement. Universities are currently spending about $60 million annually on equipment from operating and capital funds. Assuming, very conservatively, however, a fifteen year replacement cycle, they should be spending about $100 million a year. Clearly, a significant gap remains which needs to be addressed.



Deferred Maintenance

Over fifteen years have passed since the Council of Ontario Universities first quantified funding requirements for the cyclic renewal of physical plant. In some seminal work on building life costs, COU examined the expected life cycle of building components - heating, ventilation, and air conditioning systems, electrical systems, roofing, surfaces, etc. - in order to predict the annual level of expenditure required to sustain a programme of building renewal. It estimated the pace of expenditure at 1% - 2.5% of building value each year dependent on the type of building under consideration. Using the lower value, the assumption is made that a structure thus maintained will be entirely renewed once every hundred years. By commercial standards, this is a very conservative factor to apply to building renewal.

In its funding advice for 1978-79, the Ontario Council on University Affairs adopted 1% of building value as its means of assessing the need for funding for major repairs, renovations and alterations. It has continued to use this measure ever since. Its recommended funding level for 1989-90 was $40 million based on an estimated physical plant value of $4 billion. Consistent with the record of the past decade, government grants for this category of expenditure were about half the recommended level, i.e., $20 million. OCUA's recommendation for 1990-91 is $42 million.

As OCUA notes in its most recent advisory memorandum on this matter, "...the cumulative shortfall in Government funding for cyclical renewal from the inception of Council's advice on this matter to the present amounts to $287 million in 1989 dollars." It assumed this shortfall to be a fair proxy for the value of the deferred maintenance in the Ontario university system.

The shortfall identified represents slightly over 7% of present building value. Several Ontario universities have conducted extensive facilities audits to assess the well-being of their physical plant. Based on these assessments, the 7% figure would appear to be a conservative estimate. Notwithstanding, COU strongly supports the OCUA recommendation that the government address this cumulative shortfall over a ten year period, starting in 1990-91 with an allocation of $28.7 million.

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